HELP ?

Contrary opinion: Who's afraid of the WTO?

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Abstract:
*Three points are made on the issue of trade and national sovereignty. First, increasing economic integration among countries is a fact of life in the world economy, and policies that seek to insulate a country from world markets carry a heavy economic cost in themselves. Second, while a country's social regulations may sometimes come under pressure from international trade and competition, as a practical matter a country's autonomy over is own regulatory environment is rarely compromised by trade itself. Third, comprehensive solutions to problems among countries of conflicting national social and environmental standards will be possible only through the construction of new international institutions - not a grafting of new rules onto existing trade agreements and institutions such as the **WTO**.*

Full Text:

[Headnote]
This economist argues that social standards and regulations rarely affect the course of international trade or capital movements. He maintains that common standards among nations should be set by institutions other than the WTO.

International trade policy has always been linked in some way to a country's control over its domestic economic environment, so it is not surprising that the World Trade Organization (WTO) and other trade liberalization agreements are seen in some quarters as a threat to various members' sovereignty. Such agreements, by their very nature, commit the signatories to loosen their control over market access by foreign firms and investors, and it is therefore unavoidable that they require the sacrifice of some measure of national sovereignty. As soon as foreign competition is allowed to penetrate a country's borders, either through import competition or export opportunities, the government's control over the economy necessarily diminishes.

Openness to global competition, it is argued, should not force countries to compromise on their own environmental, health, safety, and labor standards. In this context, market forces are alleged to impose severe competitive pressures on industries, in turn putting pressure on governments to weaken domestic standards. It is feared that the resulting ratcheting down of regulations, driven by competition from countries with the weakest controls, leads to a "race to the bottom" by all countries in order to keep their firms competitive in open global markets. The loss of domestic control is, by this reasoning, a cost of freer trade, and imports from more weakly regulated countries are a manifestation of "social dumping."

This article sets out to make three points on the issue of trade and national sovereignty. First, increasing economic integration among countries is a fact of life in the world economy, and policies that seek to insulate a country from world markets carry a heavy economic cost in themselves. Second, while a country's social regulations may sometimes come under pressure from international trade and competition, as a practical matter a country's autonomy over its own regulatory environment is rarely compromised by trade itself. Third, and most important, comprehensive solutions to problems among countries of conflicting national social and environmental standards will be possible only through the construction of new international institutions-not a grafting of new rules onto existing trade agreements and institutions such as the WTO.

Sovereignty as an Economic Issue

Bernard Crick, writing in The International Encyclopedia of the Social Sciences, defines sovereignty as part of a theory of politics that requires every government to have within it a source of absolute power of final decision and the ability to enforce these decisions. He goes on to observe that: "Political theory has perpetually oscillated between stressing one or the other of the two primal functions of government-survival and betterment. Sovereignty sees the world in the light of survival alone and is most appropriate as a theory when the world of settled expectations seems urgently threatened."1

It is not surprising, then, that the issue of sovereignty arises as economic interdependence is progressing rapidly, apparently threatening established economic policy At the same time, the issue also reveals the difficulty governments have in simultaneously pursuing differing goals of "betterment." Should the country focus on economic efficiency through open trade, and thereby increase its welfare by the traditional measurement of the standard of living? Or should government policy seek, through regulation, to generate public goods such as a cleaner environment and to guarantee social benefits and standards for its citizens?

It is important to recognize that countries can pursue both goals, and that one may in fact reinforce the other: Richer trading countries also typically enjoy higher environmental quality and more social programs. Yet the economic adjustment and restructuring often required in an open trading environment, which is in itself the vehicle for economic betterment, can nonetheless upset "the world of settled expectations." The central question is whether sovereignty over social policies is really sacrificed in the process.

We must first ask: sovereignty over what? Legal and political sovereignty generally refers to the government's ability to enforce its own laws and maintain existing political structures within its own borders. Any voluntary sacrifice of this type of sovereignty would typically require explicit transfers of power to a supranational authority; for example, members of the European Union have transferred certain policy and legal authority to centralized institutions. But trade agreements and membership in the WTO do not involve a significant sacrifice of legal or political sovereignty, since such international institutions have no control or enforcement power over national legislatures. On the other hand, member countries do yield some trade policy autonomy by participating in international trade agreements; for instance, the North American Free Trade Agreement (NAFTA) does subject some legal decisions (especially in unfair trade law) to binational panels. But there is otherwise no sacrifice of national lawmaking or enforcement powers.

Increasing trade and economic interdependence has, however, raised a different sort of sovereignty issue. As governments have come to take a more active role in the regulation of domestic economic activity, international trade potentially threatens to interfere with the ability of governments to implement regulations and protect certain types of economic activity. A possible conflict is created between the sovereignty of domestic consumers in their consumption choices and the sovereignty of governments in regulating those choices.2 Imports are in general a "threat" to domestic regulations to the extent that consumer preferences for imported goods may undermine a governmental policy goal. This type of sovereignty threat can therefore be viewed at least in part as a conflict between the government and its own citizens.

There is, of course, a certain trade-off between internal economic control and economic efficiency This is where the gains from trade enter the picture. Most governments recognize the benefits of at least some international trade: Why else would most of them be either in the WTO or knocking on its door? It is equally true, and perhaps more compelling, to view lost national income as a cost of maintaining economic sovereignty. A government and its citizens must therefore consider how much overall economic welfare the country should give up in order to retain sovereignty over economic activity. Put another way, the sacrifice of economic sovereignty due to increased trade and investment is the result of a calculated internal decision on "betterment."

And what about domestic regulations and standards? In terms of trade-induced "social dumping," environmental degradation, and so on, the issue boils down to an empirical question and a basic cost-benefit question regarding domestic economic policy Studies of environmental policies, however, have consistently shown that environmental standards have little, if any, impact on international industrial location, in part because they represent a small portion of manufacturing costs. In fact, multinationals gear their internal environmental standards to those of the most demanding market, since future market conditions are likely to require higher standards. This "California effect" leads to the harmonization of higher environmental standard in some markets.3

Basic social protections in advanced industrial countries, such as laws governing child labor, are also unlikely to have a large impact on the pattern of industrial location. The products that would be most affected by such laws would not be produced in labor-scarce industrial economies anyway. In general, in my view, the claims that trade erodes social and environmental standards have often been exaggerated. Nevertheless, many firms vulnerable to imports complain about competing with products from countries with lower labor and environmental standards, and try to justify trade restrictions through such arguments. Yet for import-competing industries, the economic issue is ultimately one of comparative costs, not social policy: Their desire for tariff and quota protection is driven by competitive pressures.

But consider those cases in which differences in social standards, combined with global competition, might have some impact on the firm's choice of location. For example, Germany's high social charges on domestic employers have arguably caused some domestic firms to relocate some production to lower-cost countries. Even here, the differential would typically have to be large in order for it to play a significant role in uprooting otherwise efficient local production. Worker productivity in advanced industrial countries, combined with the advantages of domestic market infrastructure, location, and supplier reliability, favor local production in the sort of manufacturing that is typical in these countries. Social and environmental standards are rarely enough to tilt the balance the other way.

Regarding German social charges on labor, many in Europe, even politicians, now recognize that government labor policies are flawed and that trade is not the source of the problem. The main economic effects of such policies are in fact domestic: They lead to inflexible, unresponsive labor markets, a distortion of production patterns and high unemployment. Reforms would be called for even in the absence of trade. The real economic issue, in the end, is how the regulations are affecting domestic investment, productivity, and growth, for these are ultimately the sources of increasing standards of living. Usually, trade is at most a symptom of the larger problem: The country's loss comes not from the trade accounts but from its inability to generate more economic value.

Of course, a government could insist that it has the sovereign right to continue costly policies without the competitive pressure of imports. Yet it is not clear how policies to restrict trade will eliminate the underlying problem of productivity and growth. In addition, the new tariffs or quotas are very likely to introduce additional economic costs due to market distortions, foreign tariff retaliation, and reduced incentives for efficiency and innovation. Special interest groups will come out of the woodwork to claim the necessity of protecting sovereignty in other areas that may be "threatened" by imports. The threat to sovereignty is, for the most part, a red herring here, unless one wants to make the case that a government has the sovereign right to put its people out of work, unimpeded by imports!

Still, the decision to impose a protectionist regime is the choice made by a sovereign government. Increased sovereignty in this regard comes at a price: Is the government willing to sacrifice increased economic welfare for more internal economic control? It may elect to abrogate the trade agreement and forgo the gains from trade in order to maintain internal economic control. But it cannot have it both ways-closing market access at home while asserting rights to market access abroad-unless it is in a position to impose its views unilaterally on the rest of the world. The record shows the revealed preference of governments: The WTO has some 130 member countries, reflecting a widespread willingness to sacrifice some sovereignty for the economic gains of trade.

Whose Sovereignty?

At their most extreme, proposals to use trade restrictions to protect economic sovereignty contain an element of hypocrisy. They imply a double standard: They complain that import competition compromises the ability of the government to impose its own standards, but then propose that the solution lies in using trade policy to force all other countries to adopt its standards. In the end, trade policy based on the assertion of national sovereignty typically proposes that the country dictate terms of market access based on forced harmonization with all its trading partners. The only other way to retain absolute control over a domestic regulatory regime would be complete isolation and withdrawal from the world economy, which is not only a recipe for economic disaster but also unrealistic in democratic societies. And so we come back to a plea for "free and fair" trade, even though a global trading system must rest on a multilateral, not a unilateral, notion of what is fair, unless one dominant country or group of countries can call the shots and force the others to follow.

Of course, many critics of the current world trading system propose a social agenda with admirable goals that all people of good will would support in principle: protection of the global commons, elimination of world poverty, and prevention of the economic exploitation of children, to name a few. Making import market access contingent upon harmonization with the highest standards of the rich countries is presented as a reasonable requirement to impose on the trading system.

This approach raises serious objections, however. One is that the implicit appeal to moral or natural law as a mandate for global action, on the one hand, is rarely clear-cut and, on the other, is potentially inexhaustible. For example, Steve Charnovitz has argued that "[g]eopolitical boundaries should not override the word of God who directed Noah to take two of every living creature into the Ark." Jagdish Bhagwati and T.N. Srinivasan respond by noting that "as two Hindus among nearly 900 million on this planet, we find this moral argument culture-specific rather than universal in its appeal."4 Further, from the Hindu perspective, would it not then be consistent for India to argue on moral grounds for trade restrictions against all countries that allow the slaughter of (sacred) cows? Morally based unilateral trade sanctions represent a slippery slope in trade policy because every country can find moral flaws in the policies of other countries if it looks hard enough. What is needed is a way to identify compelling global policy issues on the basis of broad consensus, scientific evidence where applicable, and systematic, coordinated action (more on that follows).

Two additional objections to unilateral action are either that such measures will be ineffective, weakening the credibility and resolve of countries to address the issue systematically, or, if they are effective, that they will do more harm than good. The "law of unintended consequences" would often intervene. Thus, attempts to eliminate poverty by enforcing a worldwide minimum wage with trade restrictions would most likely increase unemployment and poverty. A trade ban on goods made with child labor may very well increase child prostitution. Environmental anti-dumping regulations that prevent poor countries from exporting certain goods would typically reduce economic growth, possibly leading to greater deforestation as alternative fuels are no longer affordable.

Cultural Sovereignty

The conflict between trade and national sovereignty has also exhibited a cultural dimension. Just as imports allegedly threaten to compromise domestic social regulations, so may they also threaten a country's "cultural integrity" or way of life. There is in fact a long history of this sort of trade restriction, going back at least as far as ancient Greece, whose city-states often restricted trade in order to protect their citizens against "dangerous" foreign influences. More recently, such arguments have been raised in the context of Japanese trade restrictions against imported rice to protect its indigenous "rice culture" and restrictions on audiovisual entertainment services advocated by the European Union to protect against the domination of European movie and television markets by Hollywood.

It is often difficult to disentangle the cultural sovereignty motive from traditional protectionist motives in the political economy of these trade restrictions. In addition, as noted earlier, the irony inherent in such international trade conflicts is that they really place domestic government policy goals at loggerheads with domestic consumer choices. The government takes upon itself the duty of protecting its citizens from themselves, for their free choices are deemed to be detrimental to the society as a whole.

Nevertheless, members of the WTO have been discreet in their treatment of this issue. Trade rules in sensitive sectors with a cultural dimension, such as agriculture and audiovisual services, have been liberalized very slowly, and the cultural sovereignty issue, in itself, has not disrupted the global trading system in recent years.5 Ultimately, cultural objections to trade often represent a rearguard action against inexorable structural economic change and the convergence of tastes across countries. It is therefore unlikely that attempts to protect a national culture by suppressing trade can succeed in the long run. Technology alone is making access to foreign television signals increasingly difficult to regulate, for example. At the same time, there are alternative policies that can protect national culture, such as targeted income subsidies and government funding of cultural activities, which can usually avoid the international conflict that stems from trade protection.

A More Sovereign WTO?

Some critics of the current global trade regime have suggested that the solution to the problem of diminished sovereignty is to invest the WTO with new social and environmental rules that it would impose on its membership. Bruce Elmslie and William Milberg, for example, observed that the United States resolved many internal conflicts over individual states' rights by asserting federal sovereignty over internal economic affairs and imposing federal regulations and standards, thus eliminating the "race to the bottom" as an internal competitive issue.6 The corresponding solution at the global level, it is argued, would be to introduce environmental and social chapters into the WTO charter.

Such a resolution of conflicting policies and policy goals in the world economy would pose considerable difficulties. The main problem is that the General Agreement on Tariffs and Trade (GATT) and its successor, the WTO, are contractual arrangements among members. The WTO has no sovereignty over anybody, no "ability to enforce decisions" according to the definition given earlier, no policemen, and no jail. In fact, the WTO has no power to make laws as such, since it has no legislative powers comparable to those of a national government.

The most the WTO can do in this regard is to agree upon rules regarding trade policy, to judge whether member countries' laws and policies are consistent with the rules, and finally to allow compensation or retaliation if a violation is found. It cannot impose new trade legislation on its membership from above in the manner of a sovereign state overruling local laws. The "guilty" country can, in turn, either accept the decision and comply with it or, alternatively, reject the decision and take the consequences, counter-retaliate, or leave the organization. This situation may make life difficult for a country found to be in violation of the rules, but it is not the same as sacrificing sovereignty.

"Sovereignty" thus enters the debate over WTO rules only insofar as the rules affect the scope of legitimate trade policy action taken unilaterally by member countries. Elmslie and Milberg, among others, appear to advocate that the WTO incorporate new environmental and social policy rules that would allow member states to take trade policy actions to protect the environment and social regulations, measures that are currently deemed inconsistent with WTO rules. It is important to recognize that the sovereignty issue is quite different if the solution is presented in this way, for the result of such new WTO rules, as noted earlier, would be to allow one member country's sovereignty to prevail over others' on these issues. Import market access to the United States, for example, would, according to this scenario, depend upon the U.S. Congress's latest environmental or social legislation. Other countries would be forced to harmonize their regulations in order to maintain market access, and the hurdles could be raised arbitrarily on a regular basis by new legislation. "My sovereignty trumps yours" is hardly a fairminded way to deal with international trade disputes.

In fact, a moment's reflection upon this proposal will reveal why the WTO membership would reject such reforms out of hand-and not just the less-developed "polluting" countries but many of the advanced countries as well. Allowing one country's legislation to determine unilaterally the terms of market access violates the original intent of the GATT/WTO system, which is to improve the terms of market access through the systematic dismantling of trade restrictions and the regulation of trade policy rules. Without this guarantee, the benefits of membership are vastly diminished, and new rules giving expanded freedom to governments to impose new trade restrictions would severely compromise these measures. For this reason any change in WTO rules must be approved by a two-thirds majority of all member countries. On any proposal to give new powers to restrict trade on the basis of unilateral environmental or social standards, the overwhelming response among WTO member countries would certainly be: "No deal."

Needed: Global Institution Building

A strong indicator of the value of the WTO is reflected in the fact that its member countries have voluntarily ceded some control over their trade policies in order to reap the benefits of membership, that is, the gains from trade achieved through reciprocal market access. As an international organization, it is built on the simple proposition that trade is good, and trade policy rules will increase members' wealth as long as everyone abides by them. The WTO is not inimical to other goals of improving welfare in the global commons, but it is rather narrowly focused on what it can do under its members' mandate: seek greater collective gains from trade. At the same time, member countries can leave the WTO, or they can try to gather enough votes to change the rules if they are unhappy with the sovereignty-forwealth trade-off that membership implies. Or they can push or violate the rules and take the consequences, but they should realize that breaching the rules weakens the system and may backfire when others try the same trick. In any case, it is crucial to recognize that the WTO has not stolen sovereignty from anyone; the decision to join or leave ultimately lies with the sovereign state.

The consensus underlying the WTO is therefore tightly focused on the gains from trade, and a comparable global consensus on what should be done to protect the environment or promote social goals, unfortunately, does not exist. Rather than graft these goals onto WTO rules, which its members would be unlikely to accept in any case, the proponents of environmental and social agendas need to focus on building their own international institutions to support these goals.

The framework for such institutions already exists in the form of the International Labour Office, various international environmental treaties, the UN Charter on Human Rights, and regional economic associations such as the European Union and NAFTA, both of which contain social and environmental provisions. The difficult job will be to generate a consensus among nations to basic principles of global environmental and social standards, with sets of rights and obligations among the members that bind them together. Such institutions will also require credible instruments of collective enforcement, based perhaps on a system of fines, sanctions, or even rewards. A broad-based package of incentives will in fact probably be necessary in order to motivate some countries (especially the poorer ones) to sacrifice some of their sovereignty over these issues to a supranational organization. Yet, in the end, the achievement of global "pooled sovereignty" through a world environmental organization or convention on health and safety standards would be worth the effort. For then the organization can proceed on the basis of a collective commitment to action and a legitimate transfer of powers to a multinational authority.

For those who fear the loss of economic sovereignty to international trade, there is bad news and good news. The bad news is that global competition is likely to play a large and perhaps increasing role in determining the pattern of economic activity in coming years, diminishing the ability of governments to influence the composition of production, consumption and employment. The good news is that these same global markets are not as inimical to domestic social and environmental regulations as it may at first appear. The influence of differing standards on the location of production has been small and is swamped by other economic forces. These forces have favored the protection of domestic regulatory regimes through the ratcheting up of standards. Attempting to shore up "sovereignty" by restricting trade would be economically costly and significantly weaken the WTO.

All this leaves much to be done in terms of pursuing global social and environmental goals. The best approach to achieving these goals lies in building new environmental institutions. To be sure, solving the problems will take much hard work and negotiation, and probably many years. This is perhaps also part of the bad news. However, if the global issues of the environment and social welfare are worthy of a comprehensive solution, they deserve the same considerable effort that established the lasting postwar economic institutions-the GATT/WTO, the International Monetary Fund, and the World Bank. Progress will be made only through negotiations that establish consensus on the far-reaching (and often costly) goals and the means of achieving them. Pooling sovereignty, not clinging to national versions of it in the face of global competition, is the way forward.

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1. Bernard Crick, "Sovereignty," in International Encyclopedia of the Social Sciences, vol. 15, ed. David L. Sills (New York: Macmillan and Free Press, 1968). 2. Nonmarket economies provide an even more extreme example of economic sovereignty, in which the state asserts absolute control over most, if not all, economic activity, including the determination of prices, incomes, and output according to a centralized plan. 3. On industrial location, see Arik Levinson, "Environmental Regulations and Industry Location: International and Domestic Evidence," in J.N. Bhagwati and R. E. Hudec (eds.), Fair Trade and Harmonization: Prerequisites for Free Trade? vol. 1 (Cambridge, MA: MIT Press, 1996). On the California effect, see David Vogel, Trading Up: Consumer and Environmental Regulation in a Global Economy (Cambridge: Harvard University Press, 1995).

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4. Steve Charnovitz, "GATT and the Environment: Examining the Issues," International Environment Affairs 4, no. 3 (summer 1992): 11; J. Bhagwati and T.N. Srinivasan, "Trade and the Environment: Does Environmental Diversity Detract from the Case for Free Trade?" in Bhagwati and Hudec (eds.), Fair Trade and Harmonization, which also quoted Charnovitz. 5. A dispute between the United States and the European Union, based in part on cultural issues over audiovisual services trade, threatened to scuttle the entire Uruguay Round of GATT negotiations in 1994. It is instructive to note that cooler heads prevailed, setting this particular dispute aside without resolution, so that the Uruguay Round as a whole could be completed. 6. Bruce Elmslie and William Milberg, "Free Trade and Social Dumping: The Lessons from the Regulation of U.S. Interstate Commerce," Challenge (May/June 1996).

[Author note]

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